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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 203

APPALACHIAN POWER COMPANY,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
Respondent.

PETITIONER'S REPLY TO RESPONDENT'S BRIEF

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APPALACHIAN POWER COMPANY, *Petitioner,* *vs.* FEDERAL POWER COMMISSION, *Respondent.*	No. 203

PETITIONER'S REPLY TO RESPONDENT'S BRIEF

To avoid examination by this Court of the issues raised by petitioner, FPC characterizes the present petition as "merely the latest in a series of consistently unsuccessful efforts to limit the [FPC's] authority over accounting . . ." (Br. p. 11). In fact, FPC has in this proceeding, for the first time, claimed for itself authority to dictate the manner of presentation of financial data in published financial statements.

The question is whether FPC can prevent a licensee and public utility subject to the requirements of SEC under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Public Utility Holding Company Act of 1935, from reporting its financial condition to its security holders and to the public in a manner approved by SEC.

Appalachian does not dispute that FPC accounting is "regulation by the informatory process" (Br. p. 11). It recognizes the right of FPC to require the filing of financial and other data of public utilities and licensees

and the right of FPC, which it has exercised, to publish such data in a form chosen by FPC. It is only such "regulation by the informatory process" that the cases cited by FPC support. The "long step in the direction of uniform accounting"* that the Federal Power Act took was the principle that any public utility or licensee must, as Appalachian does, stand ready to explain any deviation in financial statements which it prepares and distributes from those which have been made to and published by FPC.

The FPC's reliance on the *Northwestern Electric Company* case (Br. p. 15) is misplaced because, in that case, unlike this case, there was no requirement of FPC and of SEC with respect to the same subject matter. Since Northwestern Electric Co. was not subject to a requirement of each Commission with respect to the same subject matter, there obviously could be no conflict between requirements. Section 318 of the Power Act does not, however, by its terms require that there be a conflict in requirements. It expressly exempts a person from a requirement of the Power Act, and of any rule, regulation or order thereunder, if such person is subject to a requirement of SEC under the Public Utility Holding Company Act of 1935 or of a rule, regulation or order with respect to the same subject matter, unless SEC has exempted such person from its requirements.

In view of the requirement, conceded by FPC (see Br. p. 6), of SEC with respect to the reflection in financial statements of tax reductions, the plain language of Section 318 of the Power Act makes any similar requirement of FPC, even if otherwise valid, inapplicable to Appalachian.

> "In general, the effect of [section 318 of the Federal Power Act] will apparently be that com-

*S. Rep. No. 621, 74th Cong., 1st Sess. (1935) p. 53, quoted at Br. p. 12.

> panies will be subject to regulation in respect of the same subject matter by only one commission at a time, but in case a company ceases to be a holding company or subsidiary it will automatically be transferred from the jurisdiction of the Securities and Exchange Commission to that of the Federal Power Commission . . ." SEC Recommendations to Conference Committee on S. 2796.*

The necessity for this Congressional determination that, where jurisdiction over the same subject matter might otherwise be vested in two federal commissions, a company should be subject to regulation by only one Commission at a time, is amply demonstrated, not only by the subsequent and inconsistent decision of FPC in the *Alabama-Tennessee* case, referred to in the petition (pp. 12-13), but also by action of FPC and SEC subsequent to the date of the filing of the petition herein.

On July 7, 1964, FPC issued a notice of proposed rulemaking in Docket No. R-264, a copy of which is annexed hereto as Appendix A, in which FPC proposes to amend its accounting requirements applicable to tax reductions arising from the use of liberalized depreciation for tax purposes.

The Chief Accountant of SEC has, by letter dated August 26, 1964, a copy of which is annexed hereto as Appendix B, officially advised FPC that certain of the revisions proposed by FPC are inconsistent with existing requirements of SEC and, if adopted, would raise serious financial reporting problems for companies that are subject to the jurisdiction of both FPC and SEC. SEC has also indicated that one of the alternatives proposed by FPC would create a situation in which compliance with FPC's requirements

*pp. 44-45. This mimeographed document is available in "Legislative History of the Public Utility Holding Co. Act of 1935" (FPC Library File HD 2766.A4, Vol. 3).

would result in the publication of financial statements which SEC would presume to be misleading or inaccurate despite disclosure in an accountant's certificate or in footnotes to the statements.

Since FPC's standards for determining the form and content of financial data to be reported to FPC may be entirely different from the standards which SEC employs in determining whether financial data should be published in a particular form to stockholders and other investors, the objective of uniformity, however desirable from an abstract viewpoint, cannot be achieved in practice. The SEC letter also demonstrates further the obvious inaccuracy of the supposed truism asserted by FPC that there can be only one set of basic corporate accounts reflecting actual financial condition.

FPC's claim (Br. p. 17) that the free speech issue (Pet. pp. 27-28) was not raised below overlooks the fact that the issue was duly raised in Appalachian's Application for Rehearing to the Commission (R. 3348, Joint Appendix (vol. II), p. 879) and its brief to the Court below (p. 35).

Finally, FPC thinks that there is no conflict between the decision below and the *Alabama Power* case, but the decision below that:

> "The power claimed by FPC [authority to insist that the data it requires to be filed with it shall also be used by the utility in addressing its stockholders and other investors] is not in excess of the statutory grant . . ." (Pet. p. 33a)

is clearly inconsistent with the views expressed by the Court of Appeals in the *Alabama Power* case that:

> "It may be that the Alabama Company for the information of its stockholders and the commercial public as well as for its own business convenience

needs still other accounts and records. We think the [Federal Power] Commission has not authority to order entries upon any of these accounts except those which it requires kept for purposes of the Federal Act. . . ." *Alabama Power Company* v. *F. P. C.*, 134 F.2d 602, 611 (5th Cir. 1943).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

APPENDIX A

UNITED STATES OF AMERICA

FEDERAL POWER COMMISSION

Uniform Systems of Accounts for Public Utilities, Licensees and Natural Gas Pipeline Companies and Annual Report Forms FPC Nos. 1, 1-F, 2, 2-A—Prescription of Flow-Through Accounting for Liberalized Depreciation Tax Savings and Disposition of Accumulated Deferred Tax Balances	Docket No. R-264

NOTICE OF PROPOSED RULEMAKING
(18 CFR 101, 104, 105, 141, 201, 204, 205 and 260)

(July 7, 1964)

1. Notice is given, pursuant to section 4 of the Administrative Procedure Act, that the Commission proposes to amend the Uniform System of Accounts and its Annual Report forms for electric and natural gas pipeline companies for the purpose of implementing the regulatory policies determined and established in *Alabama-Tennessee Natural Gas Company*, Docket Nos. G-5471, *et al.*; Opinion Nos. 417 and 417-A, issued February 3, and April 15, 1964, respectively.

The proposed changes would eliminate the privilege presently enjoyed by such regulated companies to normalize for accounting purposes the tax benefits resulting from the use of liberalized depreciation, under section 167 of the Internal Revenue Code, and substitute therefor a require-

ment for actual tax expense accounting. This proposal also requires that accumulated deferred tax balances be maintained intact and retained by the regulated company in order to offset possible future increases in actual tax liabilities stemming from the use of liberalized depreciation in earlier years. However, the accounts previously established[1] for the normalization of such tax benefits are continued in the proposed accounting system so that companies whose gross plant investment is neither growing nor stable may continue the use of such accounts upon obtaining specific Commission authorization therefor. No modifications to the present accounting provisions are proposed with respect to tax deferrals related to the use of accelerated amortization under section 168 of the Internal Revenue Code.

2. The Commission also proposes to conform its Annual Report Forms, FPC Nos. 1, 1-F, 2, and 2-A, to show the above-described changes in the accounting system. Form Nos. 1 and 2 are the Commission's annual financial and statistical report forms for Class A and B electric and natural gas companies. Forms 1-F and 2-A are the corresponding Annual Report Forms for Class C and D electric and natural gas companies. The additional data to be incorporated in these reports will all be taken directly from the revised accounts.

3. Any interested person may submit to the Federal Power Commission, Washington, D. C., 20426, on or before August 26, 1964, data, views and comments in writing

[1]Tax normalization accounting and reporting procedures were prescribed by Commission Order Nos. 203 and 204 (19 F. P. C. 826, 837), both issued on May 29, 1958.

concerning the amendments proposed herein. The Commission will consider these written submittals before taking any action upon this proposal. An original and ten copies of any such submittals should be filed.

4. Opinion No. 417 specifically recognized that our decision—although in terms applicable only to Alabama-Tennessee—would properly and necessarily serve as a precedent in other rate cases involving the fixing of an appropriate income tax allowance for companies using liberalized depreciation. We found that the situation of the gas pipeline industry warranted the prescription of a general policy of rate flow-through. The Commission believes that the growth prospects of the electric utility industry present an equally favorable picture and require the application of the same general policy. During the period from 1953 to 1962, electric utilities increased their gross plant by an annual average of 8.8 percent.[2] The growth of electric utilities generally for the indefinite future is assured and universally recognized. Under the circumstances, flow-through is an appropriate accounting treatment for both gas pipelines and electric utilities.

5. In Opinion Nos. 417 and 417-A, the Commission determined that accumulated deferred tax balances should, in the absence of a Commission approved plan to return such balances to the ratepayers, be retained in a special account as consumer-contributed capital to meet the contingency that future actual taxes would be increased through a decline in overall tax depreciation deductions, associated

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[2]Statistics of Electrical Utilities in the United States, 1962.

with prior use of liberalized depreciation, below the level of the normal tax deductions under straight-line depreciation. This determination was rooted in our desire to insure that future ratepayers would not be called upon to pay again the cost of higher taxes resulting from rapid depreciation taken in earlier years because such contingent costs were paid in advance by past ratepayers. The Commission could not and should not recognize any such increase in tax payments as a legitimate and proper expense for rate purposes while, and to the extent that, there is an unexpended balance in this special account. We further concluded that pending the application of these deferred tax balances to this specific use, no return would be allowed upon such balances and implemented this policy by providing for an automatic deduction of the balance standing to the credit of the company in that special account from its recognized rate base. In this manner, the balance which was created for the purpose of accumulating sums to pay for any increased taxes due in subsequent years will continue to serve its intended role.

6. This objective rules out any accounting method which would automatically liquidate these accumulations irrespective of higher actual tax obligations, as would be the case if we were to retain the existing method of deferral accounting. Accordingly, under the proposed rule, the accumulated tax balances would be withdrawn and used to pay such increased taxes, but only when and to the extent that there is an actual increase in total taxes payable to the Federal Treasury because gross tax depreciation deductions are below the straight-line level. No withdrawal of accumulated balances may be made

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when the decline in overall tax depreciation deductions because of the use of liberalized depreciation in earlier years occurs during a year when the company has a zero tax arising from an operating loss. Moreover, such withdrawals must be limited in amount to the maximum tax actually incurred in a given year.

This disposition of accumulated deferred taxes is equally appropriate and necessary for both companies continuing and companies discontinuing liberalized tax depreciation. In the former case, the possibility of a future increase in taxes resulting from rapid depreciation taken in earlier years is remote. In the latter case, that possibility ripens into a certainty. In both cases, however, our basic objective of protecting the ratepayers against a duplicate charge for such higher taxes requires that when this contingency occurs the portion of current taxes attributable to the repayment of earlier tax savings under liberalized depreciation be met by withdrawals from the deferred tax accounts and disallowed for rate purposes, until those balances are exhausted. Furthermore, the accounting disposition of these tax balances is independent of the rate issue of whether increased tax expenses caused by the differential between liberalized and straight-line tax depreciation on new properties placed in service after the changeover occurs should be charged to jurisdictional customers or absorbed by the company's shareholders. Consequently, the issuance of this notice does not prejudge or affect in any manner or to any extent the wholly separate and unrelated question of whether a company whose use of liberalized depreciation results in a permanent tax reduction shall be allowed, in rates, the higher taxes on new properties resulting from the exercise of its tax option to return to straight-line depreciation.

Appendix A

The proposed rule permissively authorizes the amortization of present deferred tax balances over a period of years, upon the prior submission and approval of a detailed plan for returning such balances to the company's customers by way of refunds or rate reductions. Applications for such approval may be made at any time.

7. The proposed rule requires the transfer of all presently accumulated "deferred tax" balances shown on the books of natural gas companies and electric utilities, not returned to customers pursuant to an approved plan, to a new account. While deferred tax balances were properly classifiable in an account which is neither a liability nor a proprietorship item, we believe a new special account for possible future increases in taxes should be created. We propose that this new account should either be classified as a deferred credit or as appropriated surplus. Each of these classifications will subject these accumulations to restrictions and will satisfactorily serve the purpose of identifying the dollar balances to be deducted from the recognized rate base in Commission proceedings. The Commission desires comments concerning the relative advantages of each method with respect to such factors as the recognized per share book equity of common shareholders and the economic and legal ability of the companies to borrow money against property additions constructed with balances in this special account. The Commission also solicits comments concerning any other possible accounting treatments of such balances which will be equally consistent with the objectives of Opinion No. 417 and 417-A.

8. The deferred credit method treats these accumulated balances as revenues contributed by customers to be held to

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offset anticipated future taxes. This method also treats the portion of the accumulated balances withdrawn each year in order to meet higher tax payments as an increment to operating income. Accordingly, it automatically neutralizes higher actual tax expenses stemming from an overall decline in tax depreciation deductions due to the prior use of liberalized depreciation.

New Account 254, Accumulated Income Taxes—Restricted, would be established for the purpose of receiving all balances of accumulated deferred income taxes now in Account 282. When withdrawals of these funds become necessary, Account 254 would be debited and Account 411, Income Taxes Deferred in Prior Years—Credit, would be credited.

9. The appropriated surplus accounting method would transfer all accumulated deferred income taxes in Account 282 to Account 215, Appropriated Earned Surplus, and established a new separate account therein entitled, "Contingency Reserve for Liberalized Depreciation." Withdrawals from the contingency reserve would be made in an amount equal to the actual increase in taxes incurred and the withdrawn funds would be transferred from appropriated to unappropriated surplus. The mechanics underlying this method call for the debiting of Account 215, Appropriated Earned Surplus, and the crediting of Account 216, Unappropriated Earned Surplus.

10. The accounting and reporting requirements herein described are proposed to be issued under the authority granted by the Federal Power Act, as amended, particularly sections 301, 304, and 309 thereof (49 Stat. 854, 855 and 858; 16 U. S. C. 825, 825c, and 825h) and by the Natural

Gas Act, particularly Sections 8, 10 and 16 thereof (52 Stat. 825, 826 and 830; 15 U. S. C. 717g, 717i, and 717o). This proceeding involves only the determination of law and policy of general applicability and future effect. The matters at issue constitute legislative rules which may be promulgated without evidentiary hearing under Sections 2 and 4 of the Administrative Procedure Act (*American Trucking Association* v. *United States*, 344 U. S. 298, 318-320 (1953)). Nor is such hearing required by the accounting and reporting provisions of the Federal Power and Natural Gas Acts. (*Cf. Federal Power Commission* v. *Texaco Inc., et al.*, U. S. (1964)).

11. In consideration of the foregoing, it is proposed to amend Subchapters C, D, F and G of Chapter I, Title 18 of the Code of Federal Regulations by making the following changes in the Uniform System of Accounts:

(1) Accounts 282, 410 and 411 and such others as necessary would be revised to subject their use to the requirement that such normalized accounting procedures can only be used when specific permission therefor has been obtained from the Commission in advance. Such permission would be forthcoming upon a satisfactory demonstration that the property on which liberalized depreciation is to be continued is not affected by factors which would cause continuing increases or stabilization of the deferred tax balance.

(2) All balances attributable to the operation of gas and electric departments and of state-regulated utility departments standing to the credit of natural gas pipeline companies and electric utilities in Account 282 would be transferred, as of the effective date of this rule, to a new special account to be established in this proceeding.

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Appendix A

(3) That special account would either be established as:

(i) New Account 254, Accumulated Income Taxes —Restricted, which shall be debited with the amount of authorized withdrawals and credit Account 411, Income Taxes Deferred in Prior Years—Credit. Account 411 would be technically revised and subdivided to reflect its use for withdrawals from both new Account 254 and existing Account 282, or

(ii) New separate subaccount, entitled "Contingency Reserve for Liberalized Depreciation" in Account 215, "Appropriated Earned Surplus." This subaccount would be debited with the amount of authorized withdrawals and Account 216, Unappropriated Earned Surplus, would be credited.

(4) Authorized withdrawals from the new special account to be established in this proceeding would be restricted to the following purposes:

(i) Withdrawals shall be made when taxes actually payable have increased because of a decline in overall tax depreciation deductions, when and to the extent that such decline is attributable to earlier use of liberalized depreciation.

(ii) Withdrawal of the balances in the special account would be permitted, pursuant to a detailed plan for returning all or a portion of such balances to customers by way of refunds or rate reductions, when the plan has been previously approved by the Commission.

(iii) Withdrawals shall also be made in such manner and for such other purposes as the Commission may specifically direct or prescribe in an order or regulation.

Such decline in overall tax depreciation deductions shall be measured against the level of the normal tax deductions, under straight-line depreciation, on each of the classes of properties respectively utilized in the several utility departments described in Note B to Account 282. Balances standing in the special account would not be transferable to unappropriated surplus, to any other account, or used for any purpose not authorized herein without specific prior Commission approval.

Current records shall be maintained of remaining plant account balances and average service lives of property for which liberalized depreciation has been claimed for tax purposes in prior years in order to permit calculation or reasonable estimate at any time of the difference, if any, between unmodified straight-line depreciation and tax allowable depreciation with respect to the aggregate balances of such properties.

12. In consideration of the foregoing, it is further proposed to revise the annual report forms FPC Nos. 1, 1-F, 2 and 2-A as may be necessary to bring them into conformity with such amendments to the Uniform System of Accounts as may be adopted.

By the direction of the Commission. Commissioner Woodward dissenting filed a separate statement appended hereto.

JOSEPH H. GUTRIDE,
Secretary.

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Appendix A

Uniform Systems of Accounts for Public Utilities, Licensees and Natural Gas Pipeline Companies and Annual Report Forms FPC Nos. 1, 1-F, 2, 2-A—Prescription of Flow-Through Accounting for Liberalized Depreciation Tax Savings and Disposition of Accumulated Deferred Tax Balances	Docket No. R-264

(July 7, 1964)

WOODWARD, Commissioner, *dissenting*:

Tax advantages lawfully provided, affirmed by this Commission and sustained on judicial review cannot now be subverted under the guise of achieving an accounting objective. I recognize that the lawful delegation of power carries with it the authority to do whatever is reasonable properly to effectuate the power. The proposed amendment to the Uniform System of Accounts, in this instance, is not an appropriate subject for a rule-making proceeding since it is violative of the Natural Gas Act, the Federal Power Act, the Administrative Procedure Act and the constitutional requirements of due process of law.[1]

The Administrative Procedure Act, Section 4(2) requires a Notice of Proposed Rule-Making to state: "reference to the authority under which the rule is proposed."

[1]See *Parker* v. *Lester*, 227 F. 2d 708, 716; *Chicago Junction Case*, 264 U. S. 258, 265; *Ohio Bell Telephone Co.* v. *Public Utilities Commission*, 301 U. S. 292, 304; and *Interstate Commerce Commission* v. *L. & N. R. R. Co.*, 227 U. S. 88, 93, 94, holding that notice, right of cross-examination and presentation of evidence and other procedural rights must be accorded all parties affected.

The majority's authority stems from the ". . . regulatory policies determined and established in *Alabama-Tennessee Natural Gas Company*, Docket Nos. G-5471, et al., Opinion Nos. 417 and 417-A, issued February 3 and April 15, 1964, respectively."[2]

It is inconceivable that the deficient record in *Alabama-Tennessee, supra,* is now being twisted in an attempt to afford a competent basis for the type of action advocated by the majority herein. There has been no opportunity granted for any natural gas or electric power company to perfect a record on which issues of such magnitude might be completely tried and adjudicated in a legal proceeding.

A hearing is required *because adjudicative facts are in dispute.* The Supreme Court has declared: "A hearing in its very essence demands that he who is entitled to it shall have the right to support his allegations by argument however brief, and, if need be, by proof, however informal."[3] The original notice in *Alabama-Tennessee* never indicated that possible abandonment of Commission use of tax normalization would be in issue. Instead, the Commission issued a perfunctory invitation[4] for all companies to argue a limited issue[5] *after the record had been closed.* This tactic cannot possibly satisfy the requirements of procedural due process. Only a complete record would

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[2]Mimeo, P. 1.

[3]*Londoner* v. *Denver,* 210 U. S. 373, 386.

[4]Order of June 1, 1962.

[5]The issue was defined in the June 1, 1962 order and summarized by the Commission at mimeo. P. 1 of Opinion No. 417: "The specific issue is whether Alabama-Tennessee's allowance for Federal income taxes should be based on the liberalized depreciation deductions which it uses or on straight-line depreciation deductions and if the latter is used whether it should be permitted to earn a return upon the accumulated deferred tax funds, and if so, at what rate."

forcefully show that there is no basis for the Commission order requiring flow-through.

All parties having a sufficient interest or rights at stake in a determination of governmental action are entitled to know and to meet the issues. Before making any determination such as that envisaged herein, the Commission is bound by law to afford the natural gas and electric power industries full opportunity:

1. To intervene at the hearing stage.
2. To present evidence.
3. To cross-examine.
4. To submit briefs and arguments to the Examiner.
5. To present briefs and arguments to the full Commission.

These basic procedural safeguards having been summarily denied, the notice and proposed rule must fall because they are based on a legally deficient record. The substantive right of due process cannot lightly be cast aside. Mr. Justice Frankfurter has stated: "The history of liberty has largely been the history of procedural safeguards."[6] By failing to afford all companies the opportunity to participate in the presentation of evidence and in cross-examination, no order in these proceedings can lawfully be made applicable to them.

The majority has misapplied the controlling statutes: it has acknowledged the congressional goal but has appropriated to itself the responsibility of deciding how the tax policy is to be furthered. This is a logical absurdity. I would remind my colleagues of the stern admonition voiced by

[6] *McNabb* v. *United States*, 318 U. S. 332, 347.

Appendix A

Senator Milward L. Simpson during a recent Senate debate:[7]

> "This debate poses a fundamental moral question—is the law what the Congress determines that it is by majority action after careful deliberation—or is the law what an appointed agency or commission decides it should be? Have the independent agencies become so independent of Congress that they can subvert the law with impunity? Do they not have the same obligation to support the law that is demanded of every citizen? Is it they or Congress which sets tax policy?"

The majority has committed error in affording inadequate opportunity for complete party participation in the proceeding that has given rise to the proposed notice and rule. That proceeding reversed the plan chosen by Congress to achieve the goal of higher levels of company investment. Their action violates the most elementary principles of procedure and due process. The majority should confess error since the present record does not provide a fair or legal basis for reconsideration of the congressional and court approved use of tax normalization.

Pointedly I conclude that this is neither the time nor the place to implement the regulatory policies determined and established in *Alabama-Tennessee, supra.* Any such proceeding should be suspended pending congressional action and final judicial review.

HAROLD C. WOODWARD,
Harold C. Woodward, Commissioner

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[7]110 Cong. Rec. No. 21, 88th Cong., 2d Session, P. 1987-1988, February 5, 1964.

APPENDIX B

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C.

Office of the Chief Accountant

August 26, 1964

Federal Power Commission
Washington, D. C. 20426

[Received
Aug. 27, 9:33 A. M. '64]
Federal Power Commission]

Attention:

Mr. Joseph H. Gutride,
Secretary

[Federal Power Commission]
[Docketed]
[Aug. 27, 1964]
Docket Section

Re: Docket No. R-264—Notice of Proposed Rulemaking (18 CFR 101, 104, 105, 141, 201, 204, 205 and 260)
(July 7, 1964)

Gentlemen:

This letter is in response to your notice of proposed rulemaking cited above. The Commission has authorized me to advise you that with respect to the proposed "Prescription of Flow-Through Accounting for Liberalized Depreciation Tax Savings and Disposition of Accumulated Deferred Tax Balances," certain of the provisions therein relating to the disposition of accumulated deferred tax balances are inconsistent with the published policy of this Commission and, if adopted, would raise serious financial

reporting problems for companies that are subject to the jurisdiction of both the Federal Power Commission and this Commission.

This Commission announced a "Statement of Administrative Policy Regarding Balance Sheet Treatment of Credit Equivalent to Reduction in Income Taxes" in Accounting Series, Release No. 85, February 29, 1960. The position of the Commission, to which it still adheres, was expressed as follows:

> "For the foregoing reasons, on and after the effective date of this statement of administrative policy, any financial statement filed with this Commission which designates as earned surplus (or its equivalent) or in any manner as a part of equity capital (even though accompanied by words of limitation such as 'restricted' or 'appropriated') the accumulated credit arising from accounting for reductions in income taxes resulting from deducting costs for income tax purposes at a more rapid rate than for financial statement purposes will be presumed by the Commission to be misleading or inaccurate despite disclosure contained in the certificate of the accountant or in footnotes to the statements, provided the amounts involved are material."

The release was promulgated under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940. In the preparation of the release, consideration was given to opinions expressed on the subject in extensive written comments and two days of oral presentations before the Commission. The comments included a letter dated February 12, 1959, from your Commission over the signature of Chairman Jerome K.

Kuykendall to Edward N. Gadsby, the then Chairman of this Commission, which expressed general approval of the position as adopted in the release.

One of the alternatives for the disposition of accumulated deferred taxes proposed in your release, if adopted, would be in conflict with this Commission's Statement of Administrative Policy cited above. This alternative is described in paragraph 9 of your release as the "appropriated surplus" accounting method.

Your other alternative, referred to as the "deferred credit" accounting method, would be consistent with the policy expressed in our Release No. 85 and this Commission suggests that if you should determine to require abandonment of deferred tax accounting generally by companies subject to your jurisdiction, the existing balances in deferred tax accounts be dealt with solely under this alternative.

Yours very truly,

ANDREW BARR,
Chief Accountant